Jumping on PE train

Rising awareness has helped boost the attractiveness of PE as an alternative funding and investment option

by Stephanie Jacob

AMID the current low yield environment, investors who are seeking good returns through the public equity sphere are faced with a dearth of deals. On the other hand, small and medium enterprises (SMEs) and start-ups are finding it difficult to secure funding to grow their businesses.

Rising awareness – combined with a slew of positive factors, the most notable being a surge in the understanding of private equity (PE) – has helped boost the attractiveness of PE as an alternative funding and investment option.

PwC Malaysia and PwC Vietnam deals leader Tan Siow Ming foresees tremendous growth potential for PE over the next five to 10 years as Asean economies continue to expand.

"I would categorise the PE market in Southeast Asia and Malaysia as an emerging market," he tells ***FocusM***. "I see global and regional PE funds seeking to invest in businesses that can be scaled rapidly to capture the growing demand for goods and services in Southeast Asia."

Bridging the funding gap

This influx of PE funds augurs well for both SMEs and start-up companies which are feeling the squeeze as bank lending becomes more stringent while public equities funding tends to flow more slowly to them.

"When large public institutions invest in the public equities market, most of the time they are using a 'trading-based' investment approach," CMS Opus Private Equity managing director Azam Azman tells ***FocusM***. "They buy and sell via on- or off-market transactions to ensure that they have the needed liquidity and obtain the needed returns via capital gains and dividends."

Such market manoeuvres benefit the larger entities who also have more access to cheap loans from banks. Unfortunately, the same cannot be said of SMEs which make up 97% of total business establishments.

Azam says PE can bridge funding gaps

Rather, SMEs tend to be the first to face funding turbulence such as loan cuts when economic sentiment is weak. Azam says that this is where PE can play an important role in enabling these companies' to progress through their growth cycles.

Potential Excelerate Group Ltd founder and managing director Datuk Seri Sherwin Chew concurs that PE funding can fill the void in the event bank financing does not materialise as hoped.

"There is a lot of good potential among SMEs but the problem is that a good business idea without money is useless," he tell ***FocusM***. "You need money to develop the true potential of that company."

An investment option

Importantly, he points out that with PE funding, the benefits for companies go beyond just securing capital.

"With PE, it is not just about investing in the company per se; an investor will also be assessing how their connections and team of professionals can add value to the company that they are investing in to enhance and create greater value," argues Chew. "In this sense, getting funding from PE differs from getting it from banks. With banks, they give you the money and you have to figure out the rest."

Importantly, it is not just companies searching for investors which are benefiting from the development of the PE segment. Investors are also finding that using PE can be an avenue for better returns in an unexciting economic environment.

Tan defines the PE sector as emerging

Gobi Partners' investment director Victor Chua says the unexciting public equities market is pushing investors out as they are reluctant to take too much unjustified market risks. In fact, it is also forcing them to seek alternatives.

"As such, funds have to explore other options in terms of investment opportunities," reckons Chua. "Large established funds have to look for asset classes that can provide similar returns with justifiable risks."

Therefore, funds which already have PE as an allowable asset class under their strategic asset allocation will definitely consider more PE investments as a substitute to public equities investments. Those who do not have PE as an asset class will need to quickly re-design their strategy to take advantage of opportunities being presented by PE.

Chua suggests companies should expand regionally to be more attractive to PE investors

Towards this end, PwC's Tan is of the view that in the current depressed capital markets – and with lingering uncertainties in the economic outlook – entrepreneurs who are seeking growth capital may find PE a more interesting option. He further expresses belief that the PE outlook is both "positive and interesting" as plenty of opportunities abound.

"Malaysia offers an interesting market for PE funds with its large pool of SMEs, a vibrant and urban consumer class that is growing and generally transparent regulations for businesses to flourish," he justifies. "We have a strong entrepreneurial culture among our SMEs, relatively good management talent and fairly good accounting standards relative to other territories in Southeast Asia."

Tan points to sectors such as fast-moving consumer goods (FMCG), healthcare, education, logistics, consumer services and retail as particularly popular with PE funds right now.

Room to grow

Nonetheless, it is still important for funds to be discerning about companies they choose to invest on and be aware that cutting viable PE deals requires hard work.

Part of this stems from the fact that companies are largely more familiar with traditional sources of funding. This is particularly so for smaller owner-operated companies which tend to be more conservative and concerned over the higher risk that is seen to come with PE.

"There is an education process required to help them see the benefits of having a PE fund as a shareholder," adds Tan.

Given that the PE space is still growing, investors looking to move into the PE segment should not be worried about overcrowding.

"I do not think it is a crowded marketplace as yet," says Gobi's Chua. "In many ways, I do see the opportunities in the PE segment for a larger role for corporates, multi-national companies and big-cap companies."

CMS Opus' Azam sees the potential for shariah-compliant PE firms to flourish in the market by taking advantage of Malaysia's ambition to be a centre for Islamic finance. FocusM

How to attract PE investors

AN SME or start-up looking to tap into a private equity (PE) funding stream must ensure that the make-up of the company is in line with the business type a PE investor would be interested in.

While different sectors and businesses will come with different factors of considerations, there are some basic measures most PE funds will assess before investing.

Potential Excelerate Group Ltd founder and managing director Datuk Seri Sherwin Chew says he looks at three particular areas when assessing a potential investment. The first thing he does is to evaluate the strength of the prospective company's management team.

"It starts with the team – their founders and co-founders; do they have a strong entrepreneurial instinct and a competent strategy," suggests Chew. "If you have a very good idea but the team lacks ability, then there is no execution power. There are many good deals but without a good entrepreneur it will be a challenge."

Next, Chew looks at the sector or industry from which the company comes from. For him personally, the ICT sector is currently the most attractive as it has the ability to create high-growth companies.

Finally, comes the question of whether there is an exit opportunity. "In PE, we are much more focused on the exit strategy; only if we see an exit opportunity do we find an entry point," he explains.

Gobi Partners' investment director Victor Chua says that companies which have regional growth prospects will tend to be more attractive for PE investors.

"At this point, most of the investment opportunities are country-centric ... Companies should start looking at how they can scale regionally," he argues. "This helps with diversifying country risks and will attract more PE firms to invest in them."

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